No. 13734.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

THE ALBERTSON COMPANY, a Corporation,

Appellee.

On Appeal From the United States District Court for the Southern District of California.

BRIEF FOR THE UNITED STATES.

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BRIEF FOR THE UNITED STATES.

Opinion Below.

The District Court wrote no formal opinion in this case.

Jurisdiction.

This appeal involves federal income and personal holding company taxes for the years 1944 and 1945. The taxes in dispute were paid on or about September 16, 1947. Claims for refund were filed on or about September 6, 1949, and were rejected by notice dated July 10, 1950. Within the time provided in Section 3772 of the Internal Revenue Code and on July 25, 1950, the taxpayer brought an action in the District Court for recovery of the taxes paid. [R. 41-42.] Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346. The judgment was entered on October 8, 1952.

[R. 58-59.] Within sixty days and on December 5, 1952, a notice of appeal was filed. [R. 60.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether, in determining gain under Section 111 of the Internal Revenue Code on the sale of certain real property in 1944 and 1945, the taxpayer may include in the "adjusted basis" of such property within the meaning of Section 113(b) certain taxes and other charges, which were paid by the taxpayer when it purchased the property in 1923 through 1928, and for which the taxpayer took deductions on its tax returns which were allowed by the Commissioner in determining the taxpayer's taxable net income for such prior years.

Statute Involved.

INTERNAL REVENUE CODE:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be in excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized

for the purposes of this chapter, shall be determined under the provisions of section 112.

* * * * * * * *

(26 U. S. C., 1946 ed., Sec. 111)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property, except that—

* * * * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) [as amended by Sec. 130(b), Revenue Act of 1942, c. 619, 56 Stat. 798.] For expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

* * * * * * * *

(26 U. S. C., 1946 Ed., Sec. 113.)

Statement.

The facts in this case were stipulated. [R. 31-42.]

The Albertson Company (hereinafter referred to as taxpayer) is a corporation organized under the laws of the State of California and maintaining its principal

place of business in Los Angeles. During 1923, 1924, 1926, 1927 and 1928, the taxpayer purchased, or otherwise acquired, certain real property in Los Angeles and in Beverly Hills, California. At the time of acquisition, each of the properties were subject to a lien for real property taxes. In acquiring the property the taxpayer incurred additional costs in connection therewith such as escrow fees, deed recording fees, lighting assessments, commissions, title policy fees, and improvement assessments. The taxes and other charges were paid by the taxpayer at or after the respective dates of acquisition of the properties. [R. 31-36.]

In computing its federal income taxes for the years involved, the taxpayer deducted the above-mentioned payments from its gross income and such deductions were allowed by the Commissioner of Internal Revenue with tax benefits resulting to the taxpayer. [R. 37.]

In 1944 and 1945, the taxpayer sold the real property purchased between 1923 and 1928. [R. 32-37.] In determining the "adjusted basis" of such property, the taxpayer included all of the above-mentioned taxes, escrow fees, deed recording fees, lighting assessments, commissions, title policy fees and improvement assessments. [R. 4.] Upon examination of the taxpayer's corporation income and personal holding company tax returns for 1944 and 1945, the Commissioner of Internal Revenue determined that the taxpayer could not include the above-mentioned items in the "adjusted basis" of the property sold during 1944 and 1945, and assessed additional income taxes and personal holding company surtaxes against the taxpayer for such years in the total amount of $5,662.95, together with interest thereon. The taxpayer paid the assessments, filed claims for refund and, upon the disallowance thereof, brought this action for their recovery. [R. 41-42.]

Statement of Points to Be Urged.

1. The District Court erred in adopting the ruling entered in its minutes August 15, 1952. (Appendix, *infra.*)

2. The District Court erred in adopting the findings of fact and conclusions of law filed October 7, 1952. [R. 44-57.]

3. The District Court erred in adopting the judgment, docketed and entered on October 8, 1952. [R. 58-59.]

Summary of Argument.

In computing the "adjusted basis" of property under Section 113(b)(1)(A) of the Code, the *but* clause of subsection (A) expressly precludes the inclusion of taxes and other charges which have been previously deducted in computing taxable net income for prior years. In this case the taxpayer seeks to include in the "adjusted basis" of property sold in 1944 and 1945 the taxes and other charges for which it took deductions which the Commissioner of Internal Revenue allowed for the years 1923 through 1928. The charges other than taxes which the taxpayer deducted in the earlier years were rightfully deducted by the taxpayer, and the taxes were deducted by the taxpayer and allowed by the Commissioner under color of right and under what was then believed to be the applicable law. The taxes and other charges which the taxpayer claims as adjustments under Section 113 (b)(1)(A) in this case represent the "equivalent" of double deductions, which are expressly prohibited by the statute and the applicable Treasury Regulations, and which Congress, the Supreme Court, and the Tax Court have continuously sought to prevent.

ARGUMENT.

In Determining the Gain on the Sale of Certain Real Property in 1944 and 1945, the "Adjusted Basis" of the Property Should Not Include Taxes and Other Charges, Which Were Paid by the Taxpayer When It Purchased the Property in 1923 Through 1928 and for Which the Taxpayer Took Deductions on Its Tax Returns Which Were Allowed by the Commissioner in Determining the Taxpayer's Taxable Net Income for Such Prior Years.

Section 111 of the Internal Revenue Code, *supra,* provides that the gain or loss on the sale or other disposition of property shall be the excess of the amount realized therefrom over the "adjusted basis" as computed under Section 113(b), *supra.* The applicable provisions of Section 113(b) are as follows:

> (b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale of other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.
>
> (1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—
>
> (A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, *but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;* * * * (Italics supplied.)

The taxpayer in this case seeks to include in the property's "adjusted basis" under subsection (A) the taxes and

other charges paid and deducted from taxable net income from 1923 through 1928.

Adjustments and deductions such as the taxpayer here seeks are matters of legislative grace. *Helvering v. Ind. Life Ins. Co.,* 292 U. S. 371, 381; *New Colonial Co. v. Helvering,* 292 U. S. 435, 440. The Supreme Court has noted that, in granting such adjustments and deductions, Congress is opposed to double deductions for any given expenditure or charge. *Ilfeld Co. v. Hernandez,* 292 U. S. 62, 68.

From the Congressional opposition to double deductions, it is clear that, in providing for the capitalization of certain items as part of the "adjusted basis" in Section 113(b)(1)(A), Congress did not intend to include therein those items which the taxpayer had already deducted in determining its net income for prior taxable years. This intention is unmistakeably spelled out in the last part of subsection (A), italics in the above quotation and hereinafter referred to as the *but* clause.

The *but* clause specifically precludes the taxpayer from including the taxes and other charges in the "adjusted basis" as claimed in this case. The language in the *but* clause is clear and well defined. "Language used in tax statutes should be read in the ordinary and natural sense." *Helvering v. San Joaquin Co.,* 297 U. S. 496, 499. The *but* clause is unqualified and unequivocal. A literal application of the *but* clause to this case precludes the double deduction herein claimed by the taxpayer.

The legislative history of the *but* clause shows conclusively that Congress intended the literal application of the *but* clause "to eliminate double deductions or their equivalent." Treasury Regulations 111, promulgated un-

der the Internal Revenue Code, Section 29.113(b)(1)-1. Section 113(b)(1)(A) of the Internal Revenue Code as applicable to this case first appeared in its present form in Section 113(b)(1)(A) of the Revenue Act of 1932, c. 209, 47 Stat. 169. In prior Revenue Acts, the corresponding section was contained in Section 111(b)(1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, which had provided as follows:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of Gain or Loss.*—
>
> * * * * * * * *
>
> (b) *Adjustment of Basis.*—In computing the amount of gain or loss under subsection (a)—
>
> (1) Proper adjustment shall be made for any expenditure, receipt, loss, or other items, properly chargeable to capital account, * * *

Under the statutory scheme of the 1928 Revenue Act, Section 111 included provisions which covered both (a) the computation of gain or loss, and (b) the adjustments to basis. Section 113, entitled "Basis for Determining Gain or Loss," defined the term "basis." In the Revenue Act of 1932, however, the section covering the "adjustment of basis" was expanded, taken out of Section 111, and included in a revised Section 113, which was redesignated "*Adjusted* Basis for Determining Gain or Loss." (Italics supplied.)

In the form in which the Revenue Act of 1932 first passed the House of Representatives, the new Section 113(b)(1)(A) merely reenacted the old provisions of Section 111(b)(1) of the 1928 Act, as follows:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.—

(a) *Basis (Unadjusted) of Property.*—

* * * * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *.

When the above section came before the Senate Finance Committee, it was suggested during the hearings that subsection (A) be modified to read as follows (Senate Hearings on Revenue Act of 1932, pp. 1390, 1393):

(A) for expenditures, receipts, losses, or other items properly chargeable to capital account, including taxes and other carrying charges on unproductive property: *Provided, however,* That no such adjustment shall be allowed for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining taxable income in the same year or in prior years.

The above-suggested change was recommended at the Senate Hearings because the Commissioner of Internal Revenue on August 6, 1931, had just revoked the provisions of the Regulations which had previously provided that "carrying charges, such as taxes on unproductive property" must be capitalized in computing the adjusted

basis of property. T. D. 4321, X-2 Cum. Bull. 169 (1931), amending Article 561, Treasury Regulations 74, promulgated under the Revenue Act of 1928.[1] The above-suggested change at the Senate Hearing was adopted by the Senate but with slight modifications and was enacted

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[1]The amendment to Article 561 was occasioned by *Central Real Estate Co. v. Commissioner,* 17 B. T. A. 776, affirmed, 47 F. 2d 1036 (C. A. 5th), which had held that Section 202(b)(1), Revenue Act of 1926, c. 27, 44 Stat. 9, which provided for the capitalization of "any expenditure or item of loss properly chargeable to capital account," did not intend to provide for the capitalization of "carrying charges, such as taxes on unproductive property," even though the applicable Regulations provided as follows (Art. 1561, Regulations 69):

> In computing the amount of gain or loss, however, the cost or other basis of the property must be increased by the cost of capital improvements and betterments made to the property since the basic date, and by carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or used such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property. * * *

Identical language is contained in Article 561, Treasury Regulations 74. As a result of the *Central Real Estate Co.* case, T. D. 4321 was issued substituting for the above quotation the following new provisions:

> In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including the cost of improvements and betterments made to the property since the basic date. Carrying charges, such as interest and taxes on unproductive property, may not be treated as items properly chargeable to capital account, except in the case of carrying charges paid or incurred, as the case may be, prior to August 6, 1931, by a taxpayer who did not elect to deduct carrying charges in computing net income and did not use such charges in determining his liability for filing returns of income.

It was subsequently held, however, that the *Central Real Estate Co.* case represented a "misinterpretation of Congressional intention" and that taxes and interest on unproductive property could properly be capitalized under the 1926 Act and its pertinent Regulations. *Jackson v. Commissioner,* 172 F. 2d 605, 607 (C. A. 7th).

by Congress as part of Section 113(b)(1)(A) of the Revenue Act of 1932, in the following form:

> (A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years; * * *.

When the House and Senate versions of subsection (A) went to the Conference Committee, the House agreed to the modified subsection as proposed by the Senate. The Conference Report gives us the following explanation for the Senate's amendment modification (H. Conference Rep. No. 1492, 72d Cong., 1st Sess., p. 14 (1939-1 Cum. Bull. (Part 2) 539, 542)):

> This amendment permits the taxpayer to capitalize taxes and other carrying charges on unimproved and unproductive real property, but precludes the taxpayer from capitalizing any such items for which deductions have been taken by the taxpayer or predecessors in title in determining net income for the current or any preceding year; * * *

By the time Congress had reenacted Section 113(b)(1)(A) in the Revenue Act of 1934, c. 277, 48 Stat. 680, the Secretary of the Treasury had published Regulations explaining the statutory purpose and application of the *but* clause of subsection (A) as follows (Art. 113(b)-1, Regulations 86):

> *Adjustments must always be made to eliminate double deductions or their equivalent.* * * * (Italics supplied.)

The above provision of the Regulations has remained the same during all the years since 1934 and is the same as that contained in the Regulations applicable to this case. Section 29.113(b)(1)-1, Regulations 111. The fact that the above-quoted sentence from the Regulations has reappeared in the identical language in all Regulations since 1934, during which time the *but* clause has also remained unchanged in the statute, gives Congressional approval and the force of law to the above-quoted sentence from the Regulations. *Helvering v. Winmel,* 305 U. S. 79, 83; *Morrissey v. Commissioner,* 296 U. S. 344, 355; *Coast Carton Co. v. Commissioner,* 149 F. 2d 73, 74 (C. A. 9th). The only change in Section 113(b)(1)(A) during the period between the Revenue Act of 1934 and the years involved herein was made in the Revenue Act of 1942, c. 619, 56 Stat. 798, which modified subsection (A) to be applicable to taxes and other charges even if incurred on property other than "unimproved and unproductive property."[2] The fact that the *but* clause remained in Section 113(b)(1)(A) even after the "unproductive property" clause was removed by the Revenue Act of 1942 is further evidence of the Congressional intent to prevent all double deductions "or their equivalent."

As shown above, it was the intent of Congress in enacting the *but* clause to preclude such double deductions or their equivalent. In this case, the taxpayer seeks to include as part of the "adjusted basis" of its property sold during 1944 and 1945, certain taxes and other charges which it incurred, paid and deducted from its taxable income on its federal tax returns for the years 1923

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[2]In the Revenue Act of 1942, the following clause of Section 113(b)(1)(A) was removed: "including taxes and other charges on unimproved and unproductive real property." See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 47-48 (1942-2 Cum. Bull. 372, 410-411).

through 1928. In deducting such taxes and other charges from its income during those earlier years, the taxpayer was following the accepted practice at that time and was exercising what amounted to an election to make such deductions. The charges such as the escrow fees, deed recording fees, lighting assessments, commissions, title policy fees and improvements assessment in this case were properly deductible during 1923 to 1928 and the taxpayer rightfully deducted such charges in these years. The taxes on the property when purchased were at that time believed to be properly deductible by the taxpayer, since it was not until 1933 that it was first held that the California real property taxes involved here were a lien against the property. *Anderson v. Commissioner,* 27 B. T. A. 980; *California Sanitary Co. v. Commissioner,* 32 B. T. A. 122. Even after 1933 the question whether or not such taxes could be deducted as "taxes paid" under Section 23(e) of the Code was not fully settled until 1942. *Magruder v. Supplee,* 316 U. S. 394.

From the express terms of the *but* clause of Section 113(b)(1)(A) and from its Congressional background, it is clear that Congress did not intend the taxpayer to achieve a double deduction or its equivalent where the taxpayer has deducted such items in prior years, whether or not such deduction was under an express right or under what was at the time of such deduction a generally-accepted color of right. The Supreme Court, the Courts of Appeals, and the Tax Court have, wherever possible sought to prevent taxpayers from obtaining double deductions or their equivalent for any given expenditure or charge. *Ilfeld v. Hernandez, supra; Central Real Estate Co. v. Commissioner,* 47 F. 2d 1036 (C. A. 5th); *Comar Oil Co. v. Helvering,* 107 F. 2d 709, 711 (C. A. 8th);

Reliable Incubator and Brooder Co. v. Commissioner, 6 T. C. 919, 929; see *Wheelock v. Commissioner,* 77 F. 2d 474, 477 (C. A. 5th).

In four of the above-cited cases, the taxpayers had in earlier years taken deductions which the Commissioner had allowed for the prior years and when the taxpayers sought to deduct the same items in subsequent years, the courts held that Congress did not intend taxpayers to obtain double deductions or their equivalent for the same charges. *Central Real Estate Co. v. Commissioner, supra; Comar Oil Co. v. Helvering, supra; Wheelock v. Commissioner, supra; Reliable Incubator & Brooder Co. v. Commissioner, supra.* Although the *Central Real Estate* and the *Wheelock* cases involved deductions which were rightfully claimed and allowed in the earlier years, the *Comar Oil* and the *Reliable Incubator* cases involved deductions which were erroneously claimed and allowed under color of right in the earlier years. In the *Comar Oil* case, the court pointed out (p. 711) that it mattered not whether the deduction and allowance had been "rightfully or erroneously" allowed, but that, since the taxpayer had voluntarily induced the Commissioner to allow the deduction in the earlier years, the taxpayer could not complain if a second deduction or its equivalent were disallowed in computing its tax for the later year in which such deduction should properly have been taken.

The taxpayer argued below and the District Court erroneously agreed that this case represents an attempt by the Commissioner of Internal Revenue "to collect those wrongly deducted items" of 1923-1928 as to which "the statute of limitations has long since run." Appendix, *infra.* The erroneous decision of the District Court from which this appeal has been taken was based upon this

misunderstanding of the taxpayer's claim.[3] This case involves an attempt *by the taxpayer* (not the Commissioner) to obtain the equivalent of a double deduction in 1944 and 1945 for taxes and other charges which the taxpayer voluntarily deducted from its taxable income and which the Commissioner allowed under color of right for the years 1923 through 1928. In this case, the taxpayer seeks to include such taxes and charges in the "adjusted basis" of the property under Section 113(b)(1)(A). Adjustments and deductions such as those allowed in Section 113(b)(1)(A) are clearly matters of legislative grace and the burden of proving the right to the second deduction or adjustment is upon the taxpayer. *United States v. Anderson,* 269 U. S. 422. This burden the taxpayer must sustain in the face of the express prohibition of the *but* clause of subsection (A) on the deduction claimed, a prohibition reinforced by the Regulations which provide that *"adjustments must always be made to eliminate double deductions or their equivalent."* (Italics supplied.) Regulations 111, Sec. 29.113 (b)(1)-1.

There is only one interpretation which can reasonably be placed on the *but* clause of Section 113(b)(1)(A) and that interpretation precludes the adjustment and relief claimed by the taxpayer in this action. The legislative background of the *but* clause shows that if such clause is not applied to this case, then the *but* clause has no meaning. From its very language, the *but* clause ap-

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[3]Further error in the District Court's reasoning is the application of *Magruder v. Supplee,* 316 U. S. 394, to this case. In the first place, the *Supplee* opinion is inapplicable since the question there was whether certain taxes could be deducted from income as "taxes paid" under Section 23(e) of the Code, whereas here the taxes have already been deducted and allowed by the Commissioner and the question of the deductibility is moot. Secondly, in this case there are other charges in addition to taxes, and as to these other charges the taxpayer clearly exercised a proper election to deduct them in the years 1923 through 1928.

plies to all "taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for * * * prior taxable years." Sec. 113(b)(1)(A). The *but* clause applies to *all* deductions which *"have been taken"* (italics supplied) whether rightfully or erroneously taken. In this case, all the deductions other than the taxes were rightfully taken by the taxpayer during 1923 through 1928 and the taxes were voluntarily deducted by the taxpayer and allowed by the Commissioner under color of right and under what was then generally-accepted law. To allow the taxpayer's claim in this case would impute to the *but* clause of Section 113(b)(1)(A) an intent on the part of Congress to allow an adjustment representing the equivalent of a double deduction, which the very language of the *but* clause, the Regulations thereunder, and the legislative history of the clause expressly deny.

Conclusion.

The judgment of the District Court is erroneous and should be reversed.

Respectfully submitted,

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June 1, 1953.

APPENDIX.

(The following Minutes of the District Court dated August 15, 1952, were on May 13, 1953, entered by the court as part of the record, *nunc pro tunc,* and were on May 25, 1953, certified to this Court as part of the record on appeal.)

[Title of District Court and Cause.]

MINUTES OF THE COURT—AUGUST 15, 1952.

Present: The Honorable *Peirson M. Hall,* District Judge;

Deputy Clerk: Francis E. Cross.

Proceedings: Filed Stipulation of Facts.

Ruling:

The copies of briefs filed have been helpful, but the questions appear to me to be simple;

Both the taxpayer and the Commissioner of Internal Revenue, clearly made a mistake of law when the deductions were made and allowed after audit by the Internal Revenue Bureau, for the years 1923-1928. *Magruder v. Supplee* (1942), 316 U. S. 394. It is equally clear that the statute of limitations has long since run against the Commissioner of Internal Revenue to attempt to collect those wrongly deducted items. And Sections 3770 (a)(2) and 3775(a) are also clear in precluding any attempt by the Commissioner of Internal Revenue to collect those wrongfully deducted items after the statute of limitations has run. Judgment will, therefore, be for the plaintiff, who will prepare Findings and Judgment under the rules.

EDMUND L. SMITH,
Clerk,
By FRANCIS E. CROSS,
Deputy Clerk.